In the months since the U.S. Supreme Court’s June 2014 decision in Halliburton v. Eric P. John Funds, class action defendants have had no luck when attempting to take advantage of the decision’s principal holding. In Halliburton, one of the most eagerly (or anxiously) awaited securities decisions in recent memory, the court was asked to overrule Basic v. Levinson, a bedrock of securities law for more than 25 years. Basic held that investors in securities fraud actions may establish the element of reliance based on the presumption that stock prices reflect all public, material information, including alleged misrepresentations. Although the court declined to overrule Basic, it held that defendants in securities class actions should be permitted to rebut the Basic presumption at the class certification stage, rather than wait until summary judgment or trial.

The three district courts to consider defendants’ attempts to rebut the Basic presumption after Halliburton have all rejected defendants’ arguments, suggesting that defendants are still figuring out how best to utilize the decision.

Section 10(b), ‘Basic,’ and ‘Halliburton’

Section 10(b) of the Securities Exchange Act of 1934 and Securities and Exchange Commission Rule 10b-5 prohibit material misstatements or omissions in connection with the purchase or sale of a security. To prevail on a claim under §10(b), a plaintiff must show (1) a material misrepresentation or omission by the defendant, (2) scienter, (3) a connection between the misrepresentation or omission and the purchase or sale of a securities, (4) reliance, (5) economic loss, and (6) loss causation.

In Basic, the Supreme Court stated that requiring direct proof of reliance posed two problems. First, it would subject plaintiffs to a difficult evidentiary burden in that they would have to show a “speculative state of facts,” namely, how they would have acted but for the misrepresentation. Second, it would endanger securities class actions as a whole by requiring individualized inquiries into class members’ reliance.

To address these issues, the court drew upon economic theory, specifically, the fraud-on-the-market theory, which posits that, in an efficient market, share prices reflect all publicly available information, including material misrepresentations.
The court thus held that securities fraud plaintiffs can establish reliance by invoking the presumption that, by virtue of their purchase of a stock trading in an efficient market at a given price, they were relying on any public material misrepresentations. However, the court stressed that “[a]ny showing that severs the link between the alleged misrepresentation and either price received (or paid) by the plaintiff, or his decision to trade at a fair market price” would rebut the presumption of reliance.4

In declining to overrule Basic, the court in Halliburton, with Chief Justice Roberts writing for a 6-3 majority, rejected petitioner Halliburton’s argument that Basic blindly embraced a view of market efficiency no longer supported by many economists. The court found that Halliburton failed to identify a fundamental shift in economic thinking sufficient to justify overruling a decision that, ultimately, was based “on the fairly modest premise that market professionals generally consider most publicly announced material statements about companies, thereby affecting stock market prices.”5

Halliburton further argued that Basic mistakenly assumed that investments are made in reliance on the integrity of market prices when in fact many investors, such as value investors, make their investment decisions based on the belief that the market price is an inaccurate reflection of the stock’s true value. The court responded that Basic “never denied the existence of such investors,” but concluded that “it is reasonable to presume that most investors … will rely on the security’s market price as an unbiased assessment of the security’s value in light of all public information.”6

Halliburton, however, won a consolidation prize of sorts. The court agreed that defendants should be afforded the chance to defeat Basic’s presumption of reliance at the class certification stage by offering evidence that the misrepresentation did not affect the stock price. Such evidence—e.g., event studies showing how publicly reported events affected stock price—was already admissible at the class certification stage to show that the stock traded in an efficient market, a prerequisite to plaintiff’s invoking Basic’s presumption of reliance. The court held that it made “no sense” to limit such evidence to this purpose, when such evidence could also show that the misrepresentations at issue had no impact on the stock price, rendering Basic’s presumption of reliance inapplicable.7

The value of this consolation prize was immediately cast into doubt by Justice Ruth Bader Ginsburg’s concurrence. According to Ginsburg, although Halliburton will likely broaden the scope of discovery at the certification stage, it will “impose no heavy toll on securities-fraud plaintiffs with tenable claims.”8 The early returns suggest that her prediction is being borne out.

So far, neither the truth-on-the-market defense nor evidence concerning the absence of price change has succeeded.

‘Aranaz’

In Aranaz v. Catalyst Pharmaceutical Partners,9 a district court in the Southern District of Florida rejected as a matter of law defendant’s attempt to deploy the so-called truth-on-the-market defense to defeat Basic’s presumption of reliance at the class certification stage. Aranaz concerned defendant Catalyst’s announcement that it had developed the only effective, available drug to treat a rare auto-immune disorder. The day of the announcement, Catalyst’s stock price shot up from $1.42 to $2.01. Nearly two months later, a news article reported that another drug treatment for the disorder had been available for years free of charge. In the following days, Catalyst’s stock price dropped from $2.61 to $1.52. A putative class of investors subsequently brought suit alleging violations of §10(b) and Rule 10b-5 and sought class certification.

In opposition to the motion for class certification, Catalyst attempted to rebut Basic’s presumption of reliance by arguing that the existence of the competing drug was publicly known at the time of Catalysts’ announcement. This type of argument is known as a truth-on-the-market defense and requires showing that the matter purportedly misrepresented was already publicly known, meaning the misrepresentation could not have impacted the stock price.

The district court rejected the argument as a matter of law, holding that the truth-on-the-market defense may not be used at the class certification stage because it goes to materiality. The district court reasoned that the defense, “stripped down, is merely an argument that the alleged misrepresentation was immaterial in light of other information on the market.”10 Given the Supreme Court’s ruling in Amgen v. Connecticut Retirement Plans & Trust Funds11 that class plaintiffs need not establish materiality at the class certification stage, the district court ruled that, notwithstanding Halliburton, the truth-on-the-market defense could not be raised until summary judgment or trial. The district court suggested that finding otherwise would permit defendants to end the controversy on the merits at the certification stage, because a finding that the misrepresentation was objectively immaterial would foreclose all investors’ claims. The parties filed a notice of settlement a month after the ruling.

‘IBEW Local 98 Pension Fund v. Best Buy’

In IBEW Local 98 Pension Fund v. Best Buy,12 defendant Best Buy was unable to rebut Basic’s presumption of reliance with evidence that the stock price was purportedly affected by non-actionable statements rather than the alleged misrepresentations. The case concerned a September 2010 earnings call on which Best Buy representatives stated that the company’s earnings were “on track” to meet certain projections.
Earlier that day, prior to the opening of the market, Best Buy issued a press release reporting that it expected its earnings per share to beat Wall Street expectations. In December 2010, Best Buy reported earnings that fell short of expectations, and its stock price declined 14 percent the following day. A putative class of investors subsequently brought suit alleging that the “in line” and “on track” statements on the earnings call were knowingly false or made with no reasonable basis in fact.

In opposition to plaintiff’s motion for class certification, Best Buy argued that a review of the parties’ event studies established that the alleged misrepresentations had no price impact. Plaintiffs’ event study compared Best Buy’s closing price on the day before the conference call with its closing price the day of the conference call. According to Best Buy, this meant that the event study inappropriately reflected the impact of non-actionable statements, namely, the press release Best Buy issued prior to the market’s opening the day of the call. Best Buy contended that this press release, rather than the statements made during the conference call, accounted for any purported inflation of the price. Plaintiffs did not submit a countervailing event study, and Regions argued that this doomed their class certification efforts. The court disagreed:

The defendants read too much into Halliburton… requires the plaintiffs to produce an event study in opposition to defendants’ event study on a class certification motion.15

The court’s ruling essentially took the view that, once plaintiff has carried its burden of successfully invoking Basic’s presumption of reliance, the burden shifts to defendants to rebut the presumption and plaintiff need not offer further proof of price impact. Regions has petitioned the Eleventh Circuit to grant interlocutory review of the district court’s latest order.

**Conclusion**

Although, under Halliburton, securities class action defendants now have an opportunity to rebut Basic’s presumption of reliance at the class certification stage, district court decisions to date have not pointed to a clear path to victory for defendants. So far, neither the truth-on-the-market defense nor evidence concerning the absence of price change has succeeded. Defendants will of course keep trying to find an approach that works, however. And Halliburton itself, which is now back before the district court for consideration of the parties’ dueling stock price impact studies, may be a case to watch in this regard.